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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 542.

THE CITY OF YONKERS, *Petitioner,*

against

WALTER F. DOWNEY, Receiver of The First National Bank and Trust Company of Yonkers, in liquidation.

No. 543.

JOHN J. CONDON, Mayor, GUSTAV W. KLEIN, JR., First Deputy and Acting Comptroller and RAYMOND J. WHITNEY, City Manager, acting as Commissioner of Public Safety of the City of Yonkers, constituting the Board of Trustees of the Police Pension Fund of the City of Yonkers, *Petitioners,*

against

WALTER F. DOWNEY, Receiver of The First National Bank and Trust Company of Yonkers, in liquidation.

No. 544.

JOHN J. CONDON, Mayor, GUSTAV W. KLEIN, JR., First Deputy and Acting Comptroller and RAYMOND J. WHITNEY, City Manager, acting as Commissioner of Public Safety of the City of Yonkers, constituting the Board of Trustees of the Firemen's Pension Fund of the City of Yonkers, *Petitioners,*

against

WALTER F. DOWNEY, Receiver of The First National Bank and Trust Company of Yonkers, in liquidation.

No. 545.

THE CITY OF YONKERS, as Trustee under the Last Will and Testament of Irvin Saunders, of "The Saunders Trade School Fund", *Petitioner,*

against

WALTER F. DOWNEY, as Receiver of The First National Bank and Trust Company of Yonkers, New York.

REPLY BRIEF FOR PETITIONERS.

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REPLY BRIEF FOR PETITIONERS.

The brief of the respondent, so far as bulk is concerned, is principally devoted to the establishment of propositions, the correctness of which was conceded by the petitioners. To that extent it seems to be directed to such doubts as may exist in the mind of the Court as to the propriety of our concessions and to that extent we need give it no further notice.

Reply to Respondent's Point I (A) Headed, "The Pledge by the Bank to Secure the City's Deposits Was *Ultra Vires*, Illegal and Void and Payments Erroneously Made to Redeem the Security May Be Recovered."

Under this head counsel discuss only the law in the federal courts. As our position with respect to the effect of the *ultra vires* pledge is based upon the doctrine of the New York courts, we need not consider the respondent's argument.

Reply to Respondent's Point I (B) Headed, "The Policy and Provisions of the National Bank Act Control the Consequences of the Pledge and Not the Common Law of New York."

Counsel for the respondent first argue (Br., p. 12) that the subject of the consequences of an *ultra vires* pledge is left open by the National Bank Act and that a special federal common law should govern those consequences. Counsel for the respondent say that this absence of any provision as to the effect or consequences of an unauthorized pledge does not permit the law of the State of New York to "complement" the Enabling Amendment.

This claim of the respondent is based upon the hypothesis that when Congress enacted the National Bank Act

it federalized the entire law of banking so far as national banks were concerned just as Congress when it undertook to regulate interstate commerce or navigation closed those fields to the application of state law.

This view loses sight of the fundamental characteristic of the national banking system that the national banks in their commercial transactions are governed by the same commercial laws as the other corporations and individuals with whom or in competition with whom they deal. As was said by Mr. Justice White in *McClellan* v. *Chipman*, 164 U. S. 347, 357, decided in 1896:

> "These two propositions, which are distinct, yet harmonious, practically contain a rule and an exception, the rule being the operation of general state laws upon the dealings and contracts of national banks, the exception being the cessation of the operation of such laws whenever they expressly conflict with the laws of the United States or frustrate the purpose for which the national banks were created, or impair their efficiency to discharge the duties imposed upon them by the law of the United States."

It is true that so far as the internal government of the national banks is concerned, the federal power is not only paramount, but exclusive. With respect, however, to the banking business carried on by the national banks with third parties, Congress has advisedly left the field practically unoccupied for the application of the state law, whether state statute law or state common law. It has never been held that when the court applied the *lex loci contractus* to the solution of a question of the law of —say—commercial paper arising between a national bank and an individual, the state law was unlawfully "complementing" the federal law. On the contrary, it is well-settled

that where the state commercial law has created a lien upon the assets of a national bank in favor of a depositor, and the bank thereafter fails, that lien is unaffected by any federal law with respect to the winding up of national banks such as the provision for ratable dividends (§50 of the National Bank Act, R. S. §5236, U. S. C. Title 12, §194). For example, Mr. Justice Brandeis said in *Lewis* v. *Fidelity & Deposit Co.*, 292 U. S. 559, 568 (1934):

> "Sections 50 and 52 do not prohibit liens given prior to insolvency and not in contemplation thereof, whether they arise from express agreements, or are implied from the nature of the dealings between parties, or arise by operation of law. *Scott* v. *Armstrong*, 146 U. S. 499, 510; *Earle* v. *Pennsylvania*, 178 U. S. 449, 454. The lien here asserted arises out of an agreement executed at a time when there was no question of insolvency; nor is it restricted in its operation to the event of insolvency. It may be exercised by execution or otherwise whenever the bank refuses to pay. * * * The case at bar is unlike *Davis* v. *Elmira Savings Bank*, 161 U. S. 275, relied upon by the receiver, where a New York statute dealing with the administration of insolvent banks provided that in the event of insolvency the deposits of a savings bank would be entitled to a preference."

See also the language of Mr. Chief Justice Fuller in *Scott* v. *Armstrong*, 146 U. S. 499, 510 (1892):

> "We do not regard this position as tenable. Undoubtedly, any disposition by a national bank, being insolvent or in contemplation of insolvency, of its choses in action, securities or other assets, made to prevent their application to the payment of its circulating notes, or to prefer one creditor to an-

> other, is forbidden; but liens, equities or rights arising by express agreement, or implied from the nature of the dealings between the parties, or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated. The provisions of the act are not directed against all liens, securities, pledges or equities, whereby one creditor may obtain a greater payment than another, but against those given or arising after or in contemplation of insolvency."

See also *Willing* v. *Binenstock*, 302 U. S. 272, 276 (1937) and *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131, 146 (1899).

It is quite true, as pointed out by counsel for the respondent on pages 14 and 15 of their brief, that *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938), held only that there was no federal *general* common law and that *Hinderlider* v. *La Plata Co.*, 304 U. S. 92 (1938), held that there was a federal common law as to the apportionment of the water of an interstate stream between two states. In spite of a few compressed statements in our brief where we assert that there is no federal common law instead of stating, as we usually did, that there was no federal common law of banking, we do not contend that questions such as those concerning the boundaries between states must be decided under the law of the states involved, or that in such cases as *Board of County Commissioners* v. *U. S.*, No. 14, October Term, 1939, 84 L. ed. 233, which involved an Indian's treaty rights, this Court must apply the law of the state where the cause of action arises. Our position would not be impaired even if it should be held that the method of liquidation of national banks was a matter akin to the internal management of the banks so that a federal common law should fill any

gaps that might exist in the federal statute prescribing the method of liquidation of national banks. The question here, however, is not a question of the method of the liquidation of a national bank but a question of the substantive rights of a depositor which existed prior to and irrespective of the liquidation of the bank. Congress, instead of federalizing that field, has deliberately left it to the state law so that its creatures, the national banks, may compete upon an equal footing with the state banks (*Lewis* v. *Fidelity & Deposit Co.*, 292 U. S. 559, 564, *supra*).

The distinction between pre-existing rights and those arising on insolvency was clearly pointed out in *Jennings* v. *United States Fidelity & Guaranty Co.*, 294 U. S. 216 (1935), where this Court refused to give effect to a statute of Indiana (Indiana Acts, 1928, c. 164, §13(3)) which provides that where an agent collecting bank "shall fail or be closed for business" after having received the proceeds of an item entrusted to it for collection, "the assets of such agent collecting bank * * * shall be impressed with a trust in favor of the owner or owners of such item or items for the amount of such proceeds." Mr. Justice Cardozo there said for this Court at page 225:

> "What is regulated in that section is not the relation between a bank and its correspondents during the normal course of business. What is regulated is the relation and the remedy when insolvency has set in and business is suspended. Then for the first time a trust comes into being through the action of the statute * * *. A trust so created, to arise upon insolvency, is a preference under another name."

The distinction was also pointed out by Mr. Justice Brandeis in the portion of the opinion in *Lewis* v. *Fidelity & Deposit Co.*, 292 U. S. 559, 568, quoted at page 4, *supra*.

The right of the depositor who has received an *ultra vires* pledge to retain the pledged assets until his deposit is paid is an incident of the relation between the bank and the depositor during the normal course of business. It is in substance a present interest in the specific assets pledged. In this it differs fundamentally from the right created by the Indiana statute which was at most a floating charge which fixes upon all of the assets of the bank at the instant of insolvency.

Counsel for the respondent make what is evidently an alternative assertion. They say that, instead of there being a gap where the statute needs complementing, the expressed policy and provisions of the National Bank Act compelled the conclusion of the federal courts that property which is the subject of an *ultra vires* pledge may be recovered without repaying the deposits. The brief goes no farther than assertion, however. There is no attempt to point out any provision of the National Bank Act which states that policy and no decision of this Court is cited which holds that the National Bank Act exhibits that policy. Counsel fail in their attempt to show that *Texas & Pacific Ry. Co.* v. *Pottorff*, 291 U. S. 245 (1934) so holds. (See our principal brief, p. 19.)

The National Bank Act does not even say that national banks may not pledge their assets to secure deposits. As stated by Mr. Justice Black in *McNair* v. *Knott*, 302 U. S. 369, 371 (1937):

> "For many years Comptrollers of the Currency assumed that National banks had power to give security for public deposits and approved the practice of the banks in pledging such security."

It was not until the decision of City of Marion v. Sneeden, 291 U. S. 262 in 1934, that it was determined that

such a pledge would be *ultra vires*. This state of affairs is to be contrasted with the express limitation presented in *Awotin* v. *Atlas Exchange Bank*, 295 U. S. 209 (1935), cited on page 20 of the respondent's brief. There this Court was dealing with Revised Statutes, Section 5136, paragraph 7, which provided that the business of buying and selling investment securities should thereafter "be limited to buying and selling without recourse" marketable obligations. This Court, in holding that a bank's agreement to repurchase securities in violation of this expressed limitation created no rights in the purchaser, distinguished cases of mere *ultra vires*, like the case at bar, saying (p. 214):

> "The phrase is broader than a mere limitation upon the power to contract, although embracing that limitation. It is a prohibition of liability, whatever its form, by way of recourse, 'growing out of the transaction of the business.'"

It seems to us that counsel for the respondent surrender the case when they recognize on page 24 "that as a going concern the bank would have been required to make a refund of the amount of the deposit incident to obtaining the relief sought, namely, the return of the collateral." That means that if the bank, while clearly solvent, had sought to replevy the collateral, alleging payment of the deposit, and the depositor had defended upon the ground that the alleged payment had been on a forged check and that therefore the depositor was still entitled to payment, the defense against the recovery of the collateral would have been good in law. If the depositor thus had a right to hold the collateral until his deposit was paid, irrespective of insolvency, then there was an existing property interest in the collateral which would be protected on insolvency under

such cases as *Scott* v. *Armstrong*, 146 U. S. 499, 510, *supra*, *Willing* v. *Binenstock*, 302 U. S. 272, 276, *supra*, and *Lewis* v. *Fidelity & Deposit Co.*, 292 U. S. 559, 568, *supra*.

Counsel argue (p. 24) that in some way the security "is removed" upon insolvency and that the depositor is no longer a secured creditor and merely retains the status of a general creditor. Nothing is better settled than the proposition that insolvency does not remove existing liens.

Again, in this Point, counsel for the respondent can do no more than to assert (p. 32) "that no lien could possibly arise from an invalid, illegal pledge." Characterizing the pledge as invalid and illegal is of no help in the solution of the problem. The fact remains that whatever adjectives we apply to the pledge, the collateral cannot be recovered under the law of the State of New York without repayment of the deposit. The law of New York applies, for Congress has neither federalized the whole field of national banking nor adopted any rule to cover this part of it.

Reply to Respondent's Point I (C) Headed, "The New York Law as to the Consequences of the Pledge Was Not Incorporated in the National Bank Act by Reference."

The respondent's answer is little more than a reassertion of the assertion by the Circuit Court of Appeals that a pledge which is "*ultra vires*" cannot be said to be "authorized." We think that it can and that we demonstrated on pages 24-28 of our principal brief that (especially if we grant that the original National Bank Act exhibits a policy against giving effect to unauthorized pledges), the Enabling Amendment must be held to treat as authorized *ultra vires* pledges which are effective under state decisions.

Counsel for the respondent say that the decisions of this Court give no effect to such *ultra vires* pledges by national

banks. But it is the very diversity between the federal common law and the New York common law on this point that raises the question. Counsel say that if the Enabling Amendment is construed so as to validate for national banks *ultra vires* pledges which are valid for state banks under state law, that will clash with the policy of the National Bank Act against ratable distribution on insolvency. That begs the question. If the National Bank Act says that such *ultra vires* pledges are effective, then that is the policy of the National Bank Act. We have no place in which to look for the policy of a statute except in the statute itself. One might as well say that the adoption by the Enabling Amendment of the state law as to what pledges were *intra vires* was void as out of harmony with the policy of another part of the Act in favor of ratable distribution in insolvency.

The fact cited that in no case has it been thus far held that the Enabling Amendment adopted the state law as to the effect of an *ultra vires* transaction is not surprising in view of the circumstance that in none of the cases thus far decided did the particular state law concerned give effect to *ultra vires* pledges of state banks as does the law of the State of New York.

Reply to Respondent's Point I (D) Headed, "The New York Decisions Are to the Effect That New York Courts Should Follow the Decisions of the Supreme Court in the Interpretation and Construction of Federal Statutes, and Federal Policies Thereunder Implied Including the National Banking Statutes and Decisions Construing the Same."

While the New York decisions are to the effect that the New York courts should follow the decisions of the Supreme Court in the interpretation and construction of

federal statutes, the New York courts have never held that they should follow the decisions of the federal courts as to the effect of *ultra vires* acts committed in the State of New York where no question of the construction of a statute is involved. This very distinction is brought out by the cases cited by respondent. Of the five decisions cited, the following involve the construction of federal statutes and may therefore be disregarded:

Hintermister v. *First National Bank*, 64 N. Y. 212 (1876);

Duncomb, et al. v. *N. Y. H. & N. R. R. Co., et al.*, 84 N. Y. 190 (1881);

Longley v. *Coons*, 244 App. Div. 391 (1935);

Buffalo German Ins. Co. v. *Third Nat. Bank*, 29 App. Div. 137 (1898).

One case cited, however, did involve the common law effect of an *ultra vires* act performed by a national bank in the State of New York. That case was *Appleton* v. *Citizens' Nat. Bank*, 190 N. Y. 417 (1908). Counsel for the respondent cite the following sentence from page 420 of the opinion:

> "We may further assume that in transactions by national banks we should adopt the law of *ultra vires* as it prevails in the Federal courts, and not the local law on the subject."

If counsel had read further they would have found that this assumption was for the purpose of discussion only and that the case was disposed of without deciding the point. Judge Cullen, after the quoted sentence, went on to say (p. 420):

"Yet the defendant, in our opinion, became plainly liable for the amount which it received under the *ultra vires* contract. The law which obtains in this state and in several other jurisdictions is that where one party has received the full benefit of an *ultra vires* contract it cannot plead the invalidity of the contract to defeat an action upon it by the other party (*Bath Gas Light Co.* v. *Claffy*, 151 N. Y. 24). A contrary rule obtains in the Supreme Court of the United States. * * * In a great many cases the difference between the law prevailing in the Federal courts and that in our own would lead to great difference in results. In this case, however, as the plaintiff disclaims any right to recover beyond the amount actually received by the defendant, the result is exactly the same whether we adopt one rule or the other. Whatever the difference of view there may be as to the effect of *ultra vires* on corporate contracts, in no jurisdiction can a party retain what it has received under such a contract and refuse to perform the contract."

Reply to Respondent's Point II (A) Headed, "The Payments by the Bank to the Petitioners Between March 8 and March 18, 1933, Were in Violation of U. S. C., Title 12, Sec. 91."

U. S. C., title 12, §91, provides that payments "made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, shall be utterly null and void."

McDonald v. *Chemical National Bank*, 174 U. S. 610 (1899), treated more fully at pp. 31-32 of our principal brief, holds that this section means exactly what it says and that even though the officers of a bank with full knowl-

edge of its insolvency but not in contemplation of an act of insolvency pay checks presented in the due course of business, that is not enough to make the payments void.

We say that all that the courts below held that the plaintiff had shown here was that the bank was insolvent at the time of the promulgation of the Presidential Proclamation. Hence, no more than in the *McDonald* case, was there any proof of contemplation of an act of insolvency or intention to prefer. Counsel for the respondent charge us with ignoring the decision of this Court in *Mechanics Co.* v. *Culhane*, 299 U. S. 51 (1936), which is evidently cited for a rule that payments not in the usual course of business made during insolvency are recoverable.

In the first place, the rule in the *Culhane* case requires much more proof than mere insolvency and payments out of the usual course of business, and in the second place, the payments here involved were made in the usual course.

In *Mechanics Co.* v. *Culhane*, 299 U. S. 51, *supra*, one Ekstrom, president and manager of the Mechanics Co., and a director of the Manufacturers Bank, attended a meeting with the national bank examiner, at which the examiner stated that there would be a run on the local banks and that the Manufacturers Bank could not stand a run of one business day, and at which the directors authorized the examiner to negotiate to have the bank's affairs taken over by some other bank. Shortly after leaving that meeting, he drew a check of the Mechanics Co. on the bank for over two-thirds of the deposit in the Manufacturers Bank and deposited it in another bank for collection. The next day the Manufacturers Bank closed its doors after payment of the check and the receiver brought an action for the recovery of the amount so paid out.

The depositor claimed that the facts above stated did not constitute proof of a payment in contemplation of an act of insolvency made with a view to the preference of one creditor to another. This Court, through Mr. Justice Brandeis, answered that the situation did not differ from a withdrawal by Ekstrom of his own deposit, saying (pp. 56-57):

> "We have no occasion to decide whether a stranger would be liable as for a preference, if, without suggestion from any officer or employee of the bank, he withdrew his deposit because of rumor or suspicion of insolvency. It is true that ordinarily a payment made by a bank to a depositor in the usual course of business is not recoverable, even though the bank was then clearly insolvent: Compare *McDonald* v. *Chemical National Bank*, 174 U. S. 610. But the payment here in question was not made in the usual course of business; and the Company was not a stranger. Its president and manager was a director of the bank; as such acquired in confidence knowledge of its perilous condition; and, in violation of his statutory duty as director, used that knowledge for the purpose of preferring his Company. If the deposit withdrawn had been in Ekstrom's own name, he would, obviously, have been obliged to return it. The Company is in no better position."

The rule there laid down is that where a depositor knows of the insolvency of the bank by virtue of his official connection therewith and transfers the major part of his deposit from the insolvent bank to a safer one, the payment will be deemed to be with a view to his preference over other creditors. There is no basis for deducing from the *Culhane* case a naked rule that payments made by an insolvent bank not in the due course of business are recov-

erable. Many other elements are necessary before that result can be reached.

But even the element of payment outside of the usual course of business is absent in the case at bar. "Payment outside of the usual course of business" is not a mere incantation. It means something in connection with the problem presented. It is a payment which by its size and proportion to the total deposit or perhaps by its character as a mere shift from one bank to another, or perhaps because of being made outside of the usual banking hours, bears a badge of a general attempt to obtain a preference.

Nothing of that kind characterizes the payment made pursuant to the general restrictions which were placed upon all banking by the Presidential Proclamation. Payments made in the case at bar before the appointment of the conservator were made in the usual course of business in so far as there was any banking business in the United States. There was nothing to differentiate any one of them from the millions of other transactions going on all over the country at the same time. The badge of guilt was absent.

Counsel for the respondent urge the practical construction of the statute by the Comptroller of the Currency in the light of the Presidential Proclamation as fixing the date of the act of insolvency as the last date on which the bank did an unrestricted banking business. It is said in the brief that this date was chosen by the Comptroller in all cases where a conservator was appointed and the bank ultimately was liquidated.

There seems to be a hint that the Comptroller was given some power to make such a determination by the "Bank Conservation Act" of March 9, 1933, U. S. C., Title 12, Section 201. That section is merely the short title of the act and a search of the rest of it fails to disclose any such

grant of power. Even if it be true that in every such case the Comptroller has insisted upon recovering from the depositors all payments made pursuant to the Presidential Proclamation after its promulgation, the Comptroller could do so only by force of law. If upon submission of the question to this Court it appears that he acted without the support of the law in those other cases, that is no reason why the law should support him in this case. There is no reason why his construction of the statute should be given any more weight here than his long continued construction of the statute pointed out in *McNair* v. *Knott*, 302 U. S. 369, *supra*, was given in City of Marion v. Sneeden, 291 U. S. 262 (1934).

In a case where, as here, there was no violation of Section 91 of title 12, U. S. C., prior to the appointment of the conservator, the appointment of the conservator (which is expressly made the equivalent of the appointment of a receiver by Section 203), is the first act of insolvency. Thus the date of the appointment of the conservator is the critical date for distinguishing between prior payments which cannot be recovered and subsequent payments which can be.

Answer to Respondent's Point II (B) Headed, "The Payments Made by the Bank to the Petitioners Between March 8 and March 18, 1933 Were Not Authorized Under the President's Proclamations and the Regulations Issued Thereunder."

Under this head the respondent makes the point that the regulation of the Secretary of the Treasury (Res. Br., p. 49) permitted a bank to exercise its usual banking functions only "to such extent *as its situation shall permit* and * * * for the payment of usual salaries and wages," etc.*

* The indications by italics of the amendments of March 10, 1933, on the copy on p. 47 of the Respondents' brief are correct. The indications on the copy on p. 39 of our original brief are incorrect.

It is urged that this was intended to reverse the normal rule and to place upon the banks and all persons dealing with them the burden of determining whether the bank was insolvent at the time of the payment of the salaries and wages and to render void and recoverable all such payments if the bank was insolvent.

Here again, counsel omit any attempt to enforce their construction with reason. No explanation is offered as to why the Secretary of the Treasury should have wished to put this clog upon the making of such payments "as shall be absolutely necessary to meet the needs of its community for food, medicine, other necessities of life, for the relief of distressed, for the payment of usual salaries and wages, for necessary current expenditures for the purpose of maintaining employment, and for other similar essential purposes."

It is our belief that the purpose of the qualifying words "to such extent as the situation shall permit" was to make it clear that by allowing payments of the limited permitted class the Secretary did not intend to permit payments "after the commission of an act of insolvency * * * made * * * with a view to the preference of one creditor to another, etc." and thus void under Section 91. If the Secretary had meant to make mere insolvency the test, he would have certainly used clearer language.

Respectfully submitted,

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